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Recommended Citation

American Institute of Accountants, "Natural Business Year- Its advantages to business management" (1942). *Guides, Handbooks and Manuals*. 1105.
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THE NATURAL BUSINESS YEAR

*Its Advantages to Business
Management*

(1942)



Public Information Series
American Institute of Accountants
13 East Forty-first Street
New York, N. Y.

What Is the Natural Business Year?

The natural business or fiscal year of an enterprise is the period of twelve consecutive months ending when its activities have reached the lowest point in their annual cycle. At this time—

Inventories, depleted in the active selling season, have not yet been replenished.

Receivables are at their minimum or declining, as customers remit in payment of the year's largest invoices.

Bank loans, which provide each year the cash resources required for current operation in a period of peak activity, have been liquidated, or reduced to their annual minimum.

Most enterprises, including corporations not organized for profit, have a natural business year. With the exception of public utilities, railroads and a few other industries subject to government regulation, any corporation is free to choose whatever "accounting year" is most convenient.

The natural business or fiscal year has no relation whatever to the "thirteen-month year," or to any movement for calendar reform.

WAR, WITH THE PROBLEMS IT CREATES for all industries—shortage of essential materials, shortage of man-power, higher taxes, narrower profit margins—places a high premium upon efficiency. Time is of the essence. Maximum production is the order of the day.

Now is the time to apply every known device born of American ingenuity to save a dollar, save a day, save a man. Every executive doing his best to help in the war effort, whether he is primarily concerned with supplying the needs of the armed forces or meeting the requirements of the civilian population, now is constantly confronted with questions like these:

"How can I speed up output? . . . reduce waste? . . . maintain a reasonable margin of profit? . . ."

Adoption of the natural business year is one of the answers to these questions. This pamphlet tells why.

Advantages of the Natural Business Year

The advantages lie in the facilitation of operations essential to the proper conduct of a business. For example, the preparation of

FINANCIAL STATEMENTS—Financial statements prepared at the end of the natural business year more accurately reflect the facts of the business. Inventories and receivables are usually among the most important items in the balance-sheet. Their "valuation" involves a degree of estimate ("cost or market—what is market?", "bad debt reserve"). These items are smallest at the end of the natural business year;

they have been largely converted into cash. The degree of estimate is correspondingly reduced.

Profit can be more accurately calculated at the natural year end, particularly in the case of the last-in, first-out method. Inventory has been sold, and the proceeds have not yet been reinvested in new inventory. At a later date, the complex problems of inventory valuation must be solved to calculate profit.

TAX LIABILITY—A company's tax bill for any fiscal year depends primarily upon the amount of its income. Tax liability can be computed most accurately at the end of the natural business year, because profit determined at that time reflects more facts and fewer estimates.

INVENTORY TAKING—Taking inventory at the end of a natural business year has many advantages. Stocks are relatively small and inactive, and can be checked and tabulated more quickly.

There is a minimum of interference with productive activities, because normal operations have temporarily declined at the end of the natural business year. Regular employees, relieved to some extent of their normal responsibilities, are available to assist in inventory-taking.

In some organizations, part of the work of taking inventory is distributed throughout the year. Nevertheless, there remains the last-minute task of bringing the records up to date and summarizing them, preparatory to closing the books at the end of the annual natural fiscal period.

PLANNING AND CONTROL—New policies are usually introduced at the beginning of the natural business year. Financial statements prepared at the end of such a period, because they reflect the results of these policies over one complete cycle of operations, provide management with a check on their effectiveness. Statements prepared at any other date combine

the results of parts of two distinct periods, and make comparisons between them difficult, if not impossible.

BANK CREDIT—If the business executive takes advantage of the opportunity presented at the end of the natural business year to review his past operations and plan for the future, he can most easily estimate the bank credit which will be required during the succeeding twelve months.

Before a banker passes on an application for credit, he requires a statement of financial condition. He usually prefers a statement prepared at the end of the natural fiscal year—supplemented, perhaps, by a brief memorandum concerning peak debt loads and maximum inventories—because it reflects more facts and less estimate. It is to the advantage of the applicant, also, if the financial statements submitted show the concern in its most liquid condition, which is true only at the end of a natural fiscal year.

How to Determine the Natural Business Year

Because the natural business year of an enterprise closes at the end of the month in which its activities are at or near their annual minimum, an important preliminary step in adopting the natural business year is to determine this month. (A chart which facilitates this operation is presented on page 8 of this pamphlet.)

The following examples indicate how executives in three major industries have determined natural fiscal closing dates for their organizations.

Meat Packers: Sales of meat, and consequently, packers' receivables, are relatively stable throughout the year. Production of pork and pork products is usually the largest fraction of the output. Inventories of pork in cold storage normally reach their peak in the late spring and decline to an annual minimum in October

or November. Liabilities are usually lowest in September or October.

The largest packing houses, estimated to represent more than three-fourths of the total production for the industry, close their books either on October 31st or on the last Saturday in October.

Department Stores: The annual sales peak occurs in December, reflecting purchases of holiday gifts. Inventories decline to a minimum in January, following the Christmas rush and subsequent clearance sales which reduce or eliminate broken stocks. Current liabilities are relatively low, as obligations incurred in accumulating pre-holiday merchandise have been liquidated.

It would obviously be undesirable for a department store to conclude its fiscal year on December 31st, because of relatively large stocks, expanded receivables and liabilities at that date. Moreover, the entire staff is too busy to devote the necessary attention to activities incidental to taking inventories and closing the books. Most department stores complete their fiscal year on January 31st.

Farm Equipment Manufacturers: Sales, which reach a peak in the spring, normally decline to their annual minimum in late summer or early fall. Receivables lag about a month behind sales. Inventories are lowest in the fall, before stocks are replenished for the coming production season.

More than 25 per cent of the farm equipment manufacturers, including the larger concerns in the industry, have adopted a natural business year ending on October 31st.

How to Adopt the Natural Business Year

Operations involved in adopting the natural business year are few and simple. In establishing a new corporation, the desired fiscal year is

simply written in the by-laws. For existing corporations whose fiscal year has been the calendar year, one of the first and most important requirements is to request from the Commissioner of Internal Revenue at Washington—using Form 1128—permission to effect the desired change. Requests for such permission, when based upon sound reasons, are generally approved without further inquiry. Similar permission must be secured from state authorities in states which require corporations to file income-tax returns. It is usually granted upon notification that Federal authorities have approved the change.

A separate Federal tax return must be filed for the interim period between the end of the calendar year and the beginning of the new natural fiscal year. This interim return is identical in form with the annual return. A corresponding state income-tax return, for the interim period, must be filed in states which require annual returns of corporations.

It is also necessary, if the company is subject to the jurisdiction of the Securities and Exchange Commission, to prepare an interim report for that body when the period between the end of the calendar year and the beginning of the natural fiscal year is three months or longer.

Taxes and the Natural Business Year

The incidence of new taxes and of revised tax rates upon companies closing their books at the end of their natural business year is postponed from one to eleven months. Up to the present time, changes in tax laws have become effective for each taxpayer on January 1st of a specified calendar year, or at the opening of the first fiscal year beginning after that date. When the natural business year is adopted, this time lag provides an opportunity to study the effects of new requirements and to review Trea-

Form for Use With Determination Chart

Nature of business.....	How long in business.....	Present fiscal year.....
Location of plants.....	Location of principal sources of supply.....	
Stocks listed on.....	Exchange Bonds listed on.....	Exchange
Does company use perpetual inventory system?.....	How often is physical inventory taken?.....	
Statements prepared by company monthly.....	Cumulative.....	12 months ended.....
Use made of statements prepared by company.....		
Use made of reports of auditors.....		
Does company use a budget?.....	What is fiscal year for budget?.....	
Reports to stockholders: Annually.....	Semi-annually.....	Quarterly.....
If partnership, do partners report income to U. S. Government for same period as partnership?.....		

Comments and Suggestions

The above forms are intended for use in obtaining information with for all of the columns and spaces in the chart. In others, fluctuations will regard to seasonal fluctuations in specific businesses or industries, for the be more clearly indicated by additional or substitute headings.

Information for more than one year obviously would furnish a more purpose of determining whether changes in fiscal years might be of dependable guide to seasonal fluctuations than information for only one advantage.

In many cases, it may not be practicable to obtain and list information year. Where practicable, it should be obtained for a period of years.

Additional copies of the above natural business year determination chart may be secured without charge from the American Institute of Accountants, 13 East Forty-first Street, New York, N. Y.

sure Department rulings and legal decisions.

Changing the fiscal closing date may either reduce or increase present or future taxes, depending upon a variety of circumstances. A net increase in tax liability at the time when the adjustment occurs may be more than compensated for by a net decrease in subsequent periods. The advantage to be gained by adopting the natural business year can be determined only by carefully studying the effect upon tax liability, together with all other anticipated results.

What Executives Say about the Natural Business Year

The vice president and treasurer of a steel mill writes: "It is, of course, logical to close the books at a time when inventories are at a minimum for a greater efficiency in taking inventory, because it interferes least with manufacturing operations as well as reducing the actual count in taking it. It is also at a time when our current borrowings are at a minimum or nearly eliminated."

The secretary and treasurer of a cannery writes: "Adopting the fiscal year . . . gives us a better picture of our yearly operations . . . On the fiscal year basis we have the entire operations in the one year and therefore results obtained thereby are considerably more satisfactory to us."

The vice president and treasurer of a coal company writes: "In the first place, our industry is seasonal and by using the fiscal year ending April 30th we are always sure to include the whole of the burning season within the fiscal year. In the second place, our labor contract with the miners expires on March 31st. . . . In the third place, contracts for the sale of coal are usually consummated in the spring after the wage scales have been adjusted."

The secretary of a company serving the machinery industry cites in a letter the following advantages of the natural business year as he

has found them: "Less inventory to take, because our stock is at its lowest point; the leveling off of clerical peaks by handling inventory detail during our slacker season; we present a clearer picture of operations on a natural year basis, cash, receivables and inventories not being distorted."

SUGGESTED FISCAL CLOSING DATES

The fiscal closing dates listed below are recommended by Dun and Bradstreet, Inc., as a result of studies undertaken in cooperation with the Natural Business Year Council, and by the Council, as the result of surveys conducted with the aid of trade associations and other groups.

Individual corporations, because of special circumstances, may find it desirable to adopt natural fiscal closing dates other than those listed here for the industries which they represent. In connection with dates for industries not listed below, correspondence with the distributors of this pamphlet is invited.

The recommended dates are as follows:

<i>Advertising agencies</i>	<i>December 31</i>
<i>Automobile Accessories, manufacture</i>	<i>July 31 or August 31</i>
<i>Automobile dealers</i>	<i>October 31</i>
<i>Automobiles, manufacture</i>	<i>September 30</i>
<i>Beverages, carbonated, manufacture</i>	<i>September 30</i>
<i>Books, general, publishing</i>	<i>January 31</i>
<i>Books, text, publishing</i>	<i>June 30</i>
<i>Breweries</i>	<i>December 31 or October 31</i>
<i>Candy, manufacture</i>	<i>June 30</i>
<i>Canning, fruit and vegetable</i>	<i>April 30 or February 28</i>

<i>Cement, manufacture</i>	<i>January 31</i>
<i>Clay products, manufacture</i>	<i>October 31 or March 31</i>
<i>Clothing, men's work, manufacture</i>	<i>December 31</i>
<i>Coats, fur, manufacture</i>	<i>January 31 or February 28</i>
<i>Coats and suits, women's, manufacture</i>	<i>November 30</i>
<i>Colleges</i>	<i>June 30</i>
<i>Cotton compresses</i>	<i>April 30 to July 31</i>
<i>Cotton gins</i>	<i>April 30 to June 30</i>
<i>Cotton merchants</i>	<i>June 30 or July 31</i>
<i>Cotton textiles, weavers</i>	<i>September 30 or August 31</i>
<i>Cotton warehouses</i>	<i>June 30 or July 31</i>
<i>Cottonseed oil, crude, producers</i>	<i>June 30 or July 31 (In extreme South, April 30 or May 31)</i>
<i>Cottonseed oil, refiners</i>	<i>Same</i>
<i>Cotton oil products, manufacture</i>	<i>June 30</i>
<i>Dairies and produce companies</i>	<i>February 28 or March 31</i>
<i>Drug stores, retail</i>	<i>January 31 (stores with no soda foun- tains nor novelty lines, possibly July 31)</i>
<i>Dry goods, retail</i>	<i>January 31</i>
<i>Dry goods, wholesale</i>	<i>December 31 or November 30</i>
<i>Farm equipment, manufacture</i>	<i>October 31</i>
<i>Fertilizer, manufacture</i>	<i>June 30</i>
<i>Flour, milling</i>	<i>March 31 to June 30</i>
<i>Furniture, manufacture</i>	<i>December 31 or November 30</i>

<i>Groceries, wholesale</i>	<i>June 30</i>
<i>Hardware, retail</i>	<i>December 31</i>
<i>Hats, women's trimmed, manufacture</i>	<i>May 31 or November 30</i>
<i>Heating, piping and air conditioning, contractors</i>	<i>December 31</i>
<i>Hosiery, manufacture</i>	<i>January 31, selling to retailers; December 31, selling to wholesalers and jobbers</i>
<i>Hotels, residential</i>	<i>June 30 or July 31</i>
<i>Hotels, resort (closed part time)</i>	<i>Last day of last month of season</i>
<i>Hotels, transient or all-year resort</i>	<i>Last day of various months, excepting December</i>
<i>Ice cream, manufacture</i>	<i>December 31</i>
<i>Jewelry, retail</i>	<i>January 31 or February 28 (For instalment sales, August 31)</i>
<i>Jewelry, wholesale</i>	<i>February 28</i>
<i>Jewelry, manufacture</i>	<i>March 31</i>
<i>Meat packing</i>	<i>October 31</i>
<i>Paint, varnish and lacquer manufacture</i>	<i>November 30 or December 31</i>
<i>Radio, home sets, manufacture</i>	<i>March 31</i>
<i>Refrigerators, manufacture</i>	<i>July 31</i>
<i>Shoes, manufacture</i>	<i>November 30 or October 31</i>
<i>Sugar, beet, manufacture</i>	<i>June 30</i>
<i>Sugar, cane, refiners</i>	<i>December 31 — (For Louisiana companies March 31)</i>

Endorsements of the Natural Business Year

Testimony is offered below from authoritative sources as to the value of closing the books of account at a time when the activities of a company are at their lowest point.

From the *Committee on Industrial Practices* of the *National Association of Manufacturers*, December, 1939:

"Wherever it is feasible each business firm should attempt to adopt its own natural business year as its fiscal year."

From the *Chief Accountant* of the *Securities and Exchange Commission*, March, 1940:

"Advantages to be obtained from the adoption of a fiscal year-end date which coincides with the lowest point in the annual cycle of operations are clear and to my mind have never been shown to be outweighed by related disadvantages."

From the *sub-committee on independent audits and audit procedure* of the *Committee on Stock List* of the *New York Stock Exchange*, adopted by its Board of Governors, August, 1939:

"The natural business year of an industry in which a company is engaged is recommended, unless impracticable for special reasons, as the fiscal year of the company instead of the calendar year."

In 1935, the *Natural Business Year Council* was formed for the sole purpose of distributing information about the natural business year and promoting its adoption. The Council includes representatives of the National Association of Credit Men, National Association of Cost Accountants, Robert Morris Associates, American Institute of Accountants, American Management Association and National Office Management Association.